

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
MARCH 31, 2014 AND 2013

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Mitchell County Hospital Health Systems

We have audited the accompanying financial statements of the business-type activity and discretely presented component unit of Mitchell County Hospital Health Systems (the Health System), a component unit of Mitchell County, Kansas, which comprise the statements of net position as of March 31, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the business-type activity and the discretely presented component unit of Mitchell County Hospital Health Systems as of March 31, 2014 and 2013, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A21 to the financial statements, in 2014, the Health System adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 65, "Items Previously Reported as Assets and Liabilities." Our opinion is not modified with respect to this matter.

Other Matter

The Health System has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the financial statements. Such missing information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. Our opinion on the financial statements is not affected by this missing information.

Wendling Roe Nelson & Johnson LLC

Topeka, Kansas
September 9, 2014

FINANCIAL STATEMENTS

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS

STATEMENTS OF NET POSITION

March 31,

ASSETS

	2014		2013	
	Health System	Component unit	Health System	Component unit
CURRENT ASSETS				
Cash and cash equivalents	\$ 3,570,285	\$ 37,569	\$ 4,063,031	\$ 5,627
Investments		3,706,553		3,011,065
Assets limited as to use	292,211		364,044	
Patient accounts receivable, net of allowance for uncollectible accounts of \$1,515,320 in 2014 and \$1,550,000 in 2013	4,226,599		5,196,273	
Estimated third-party payor settlements	617,396		646,703	
Other receivables	209,821		16,373	
Inventories	411,879		436,954	
Prepaid expenses	289,717		313,839	
Total current assets	<u>9,617,908</u>	<u>3,744,122</u>	<u>11,037,217</u>	<u>3,016,692</u>
ASSETS LIMITED AS TO USE				
Internally designated				
For capital assets	4,734,018		2,395,254	
For self-funded employee health insurance	408,900		587,808	
Under bond agreements	1,251,063		1,243,843	
By contributors				
For specific operating activities	35,987		54,163	
For capital asset acquisitions	84,606		253,797	
	6,514,574	-	4,534,865	-
Less amounts required to meet current obligations	<u>292,211</u>		<u>364,044</u>	
Total assets limited as to use	<u>6,222,363</u>	-	<u>4,170,821</u>	-
CAPITAL ASSETS, NET	<u>15,711,334</u>	-	<u>17,362,734</u>	-
OTHER ASSETS				
Other receivables	11,313		15,261	
Prepaid expenses	41,831		46,965	
Total other assets	<u>53,144</u>	-	<u>62,226</u>	-
Total assets	<u>\$ 31,604,749</u>	<u>\$ 3,744,122</u>	<u>\$ 32,632,998</u>	<u>\$ 3,016,692</u>

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET POSITION

	2014		2013	
	Health System	Component unit	Health System	Component unit
CURRENT LIABILITIES				
Current maturities of long-term obligations	\$ 968,200	\$ -	\$ 1,155,815	\$ -
Accounts payable	517,675		502,432	
Capital asset acquisitions payable			86,052	
Estimated third-party payor settlements	108,396		112,703	
Accrued salaries and benefits	1,105,992		1,119,564	
Accrued compensated absences	830,689		858,411	
Accrued interest payable	38,496		38,625	
Total current liabilities	3,569,448	-	3,873,602	-
LONG-TERM OBLIGATIONS, less current maturities				
	10,757,761		11,564,936	
Total liabilities	14,327,209	-	15,438,538	-
NET POSITION				
Net investment in capital assets	3,985,373		4,694,271	
Restricted				
For debt service	1,251,063		1,243,843	
For specific operating activities	11,202		11,118	
For capital asset acquisitions	84,606		253,797	
Unrestricted	11,945,296	3,744,122	10,991,431	3,016,692
Total net position	17,277,540	3,744,122	17,194,460	3,016,692
Total liabilities and net position	\$ 31,604,749	\$ 3,744,122	\$ 32,632,998	\$ 3,016,692

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
Year ended March 31,

	2014		2013	
	Health System	Component unit	Health System	Component unit
Operating revenues				
Net patient service revenue	\$ 24,151,831	\$ -	\$ 24,354,364	\$ -
Electronic health record incentives	944,591			
Other	551,845	1,129	405,054	
Total operating revenues	25,648,267	1,129	24,759,418	-
Operating expenses				
Salaries and wages	11,529,727		11,229,666	
Employee benefits	2,847,819		2,349,210	
Supplies and other expenses	8,610,168	1,002	8,277,640	40,866
Depreciation and amortization	2,368,029		2,425,716	
Total operating expenses	25,355,743	1,002	24,282,232	40,866
Operating income (loss)	292,524	127	477,186	(40,866)
Nonoperating revenues and expenses				
County tax appropriations	156,106		120,000	
Investment income	37,068	727,303	44,256	439,902
Interest expense	(497,729)		(512,464)	
Noncapital grants and contributions	84,802		42,339	
Other	500		200	
Total nonoperating revenues and expenses	(219,253)	727,303	(305,669)	439,902
Excess of revenues over expenses before capital grants and contributions	73,271	727,430	171,517	399,036
Capital grants and contributions	9,809		(2,343)	
Change in net position	83,080	727,430	169,174	399,036
Net position at beginning of year				
As previously reported	17,421,444	3,016,692	17,279,549	2,617,656
Prior period adjustment for change in accounting principle	(226,984)		(254,263)	
As restated	17,194,460	3,016,692	17,025,286	2,617,656
Net position at end of year	\$ 17,277,540	\$ 3,744,122	\$ 17,194,460	\$ 3,016,692

The accompanying notes are an integral part of these statements.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS

STATEMENTS OF CASH FLOWS

Year ended March 31,

	2014		2013	
	<u>Health System</u>	<u>Component unit</u>	<u>Health System</u>	<u>Component unit</u>
Cash flows from operating activities				
Receipts from and on behalf of patients	\$ 25,146,505	\$ -	\$ 23,820,197	\$ -
Payments to or on behalf of employees	(14,415,184)		(13,582,240)	
Payments for supplies and services	(8,525,057)	(1,002)	(8,358,652)	(40,866)
Other receipts and payments	<u>1,303,280</u>	<u>1,129</u>	<u>404,579</u>	
Net cash provided (used) by operating activities	<u>3,509,544</u>	<u>127</u>	<u>2,283,884</u>	<u>(40,866)</u>
Cash flows from noncapital financing activities				
County tax appropriations	140,569		135,537	
Noncapital grants and contributions	<u>84,802</u>		<u>42,339</u>	
Net cash provided by noncapital financing activities	<u>225,371</u>	<u>-</u>	<u>177,876</u>	<u>-</u>
Cash flows from capital and related financing activities				
Acquisition of capital assets	(802,681)		(439,603)	
Capital lease obligations incurred	159,468			
Repayments of long-term obligations	(1,155,815)		(1,234,254)	
Interest paid	(496,301)		(523,923)	
Capital grants and contributions	179,000		143,999	
Proceeds from sale of capital assets	<u>500</u>		<u>200</u>	
Net cash used by capital and related financing activities	<u>(2,115,829)</u>	<u>-</u>	<u>(2,053,581)</u>	<u>-</u>

The accompanying notes are an integral part of these statements.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended March 31,

	2014		2013	
	Health System	Component unit	Health System	Component unit
Cash flows from investing activities				
Changes in				
Internally designated funds	\$ (2,162,640)	\$ -	\$ 1,363,098	\$ -
Assets held under bond agreements	(7,426)		(13,812)	
Assets restricted by contributors	18,176		(35,016)	
Investments		(62,126)		(71,136)
Investment income received	40,058	93,941	45,297	73,759
Net cash provided (used) by investing activities	(2,111,832)	31,815	1,359,567	2,623
Net change in cash and cash equivalents	(492,746)	31,942	1,767,746	(38,243)
Cash and cash equivalents at beginning of year	4,063,031	5,627	2,295,285	43,870
Cash and cash equivalents at end of year	<u>\$ 3,570,285</u>	<u>\$ 37,569</u>	<u>\$ 4,063,031</u>	<u>\$ 5,627</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities				
Operating income (loss)	\$ 292,524	\$ 127	\$ 477,186	\$ (40,866)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities				
Depreciation and amortization	2,368,029		2,425,716	
Provision for bad debts	1,015,123		2,158,812	
Changes in				
Patient accounts receivable	(45,449)		(2,610,979)	
Other receivables	(189,500)		(15,108)	
Estimated third-party payor settlements	25,000		(82,000)	
Inventories	25,075		(33,448)	
Prepaid expenses	29,256		(26,169)	
Accounts payable and accrued expenses	(10,514)		(10,126)	
Net cash provided (used) by operating activities	<u>\$ 3,509,544</u>	<u>\$ 127</u>	<u>\$ 2,283,884</u>	<u>\$ (40,866)</u>

The accompanying notes are an integral part of these statements.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS

NOTES TO FINANCIAL STATEMENTS

March 31, 2014 and 2013

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting entity

Mitchell County Hospital Health Systems (the Health System) is owned by Mitchell County, Kansas (the County), and governed by a seven-member Board of Trustees appointed by the Board of County Commissioners of the County. The Health System is located in Beloit, Kansas, and provides acute care, swing-bed, geropsychiatric, skilled nursing, and long-term care services. The Health System can sue and be sued and can buy, sell, or lease real property. Bond issuances must be approved by the County. The Health System is a component unit of the County.

The component unit discussed in Note A2 is included in the Health System's reporting entity because of the nature and significance of its relationship with the Health System.

2. Component unit

The financial statements include the financial data of the discretely presented component unit described below. The component unit is reported separately to emphasize that it is legally separate from the Health System.

Mitchell County Community Hospital Endowment Fund (the Endowment Fund) is a not-for-profit membership corporation organized to endow the Mitchell County Community Hospital and its successors and to otherwise provide charitable support of health care, hospital, and related services in Mitchell County, Kansas. The sole member of the Endowment Fund is the Health System. The Endowment Fund is governed by a five-member Board of Directors, of which two members are also members of the Health System's Board of Trustees, and the other three members are the members of the Endowment Management Committee (the Committee). The day-to-day operating and investing decisions of the Endowment Fund are carried out by the Committee. Members of the Committee are appointed by the Board of County Commissioners of the County. Principal distributions from the Endowment Fund can only be made with approval of all members of the Committee and a majority of the Board of Directors. The Endowment Fund's bylaws restrict principal distributions to 10 percent of unrestricted net position in one calendar year and 30 percent of unrestricted net position in any period of ten consecutive calendar years.

Financial data of the Endowment Fund are presented as of December 31, 2013 and 2012, and for the years then ended.

3. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

4. Basis of accounting

The Health System uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

5. Cash and cash equivalents

The Health System considers all cash and invested cash to be cash equivalents, excluding any assets limited as to use and items classified as investments by the Endowment Fund.

6. Allowance for uncollectible accounts

The Health System provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. The Health System estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each type of payor.

7. Inventories

Inventories are stated at cost as determined using the first-in, first-out method.

8. Investments and investment income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based upon quoted prices in active markets for identical assets. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenue when earned.

9. Assets limited as to use

Assets limited as to use include assets set aside by the Board of Trustees under a self-insurance arrangement for employee health insurance and for replacement of capital assets or for purchase of additional capital assets, over which the Board retains control and may, at its discretion, subsequently use for other purposes; assets whose use is limited under bond agreements; and assets restricted by contributors for a particular purpose. Amounts that are required for obligations classified as current liabilities are reported in current assets.

10. Capital assets

Capital assets (including assets recorded as capital leases) are stated at cost. Depreciation and amortization of capital assets are provided on the straight-line method over the estimated useful lives of the assets which are substantially in conformity with the guidelines established by the American Hospital Association.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

11. Costs of borrowing

Interest costs (including amortization of bond discounts) incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Original issue discounts are amortized using the interest method over the term of the related debt. Costs incurred to issue long-term debt are expensed in the period incurred.

12. Estimated health insurance claims payable

The Health System is self-insured for health insurance claims of its employees. Management estimates the net liability for reported and unreported claims incurred as of the end of each reporting period. These estimates are based on known claims and historical claims experience.

Management believes that estimates for health insurance claims payable are reasonable. However, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

13. Grants and contributions

From time to time, the Health System receives grants and contributions from individuals and private organizations. Revenues from grants and contributions, including contributions of capital assets, are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

14. Restricted resources

When the Health System has both restricted and unrestricted resources available to finance a particular program, it is the Health System's policy to use restricted resources before unrestricted resources.

15. Net position

Net position of the Health System is classified in three components. "Net investment in capital assets" consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted net position" is noncapital net position that must be used for a particular

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

purpose, as specified by creditors, grantors, or contributors external to the Health System, including amounts deposited with trustees as required by bond agreements. "Unrestricted net position" is remaining net position that does not meet the definitions of the other two components of net position.

16. Operating revenues and expenses

The Health System's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Health System's principal activity. Nonexchange revenues, including noncapital grants and contributions and the county tax appropriations, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

17. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, contractual adjustments, and provision for bad debts, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

18. Charity care

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

19. Income taxes

The Health System is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code.

The Endowment Fund is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its related income pursuant to Section 501(a) of the Code.

20. Subsequent events

The Health System has evaluated subsequent events through September 9, 2014, which is the date the financial statements were available to be issued.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

21. Adoption of accounting pronouncement

In 2014, the Health System adopted Governmental Accounting Standards Board (GASB) Statement No. 65, "Items Previously Reported as Assets and Liabilities," which established accounting and financial reporting standards that reclassify certain items previously reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and recognize certain items that were previously reported as assets and liabilities as expenses and revenues. Comparative financial statements of prior years have been adjusted to apply this new standard retrospectively. An adjustment of \$254,263 applicable to 2012 and prior years has been included in the restated 2013 beginning net position balance of the Health System to reflect removal of debt issuance costs that were previously capitalized as an asset and amortized over the term of the related debt and to reflect removal of a deferred refunding loss which arose from the presence of unamortized debt issuance costs when the refunding occurred. This restatement increased the previously reported increase in net position of the Health System by \$27,279 as a result of removing amortization expense for the year ended March 31, 2013.

NOTE B - NET PATIENT SERVICE REVENUE

The Health System has agreements with third-party payors that provide for payments to it at amounts different from its established charge rates. The amounts reported on the statements of net position as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - The Health System is a critical access hospital for purposes of the Medicare program. Hospital services rendered to Medicare beneficiaries are paid under cost reimbursement methodologies. Inpatient geropsychiatric services rendered to Medicare beneficiaries are paid at prospectively determined rates per day. Skilled nursing services rendered to Medicare beneficiaries in the Health System's long-term care unit are paid at prospectively determined rates per day. The Health System is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health System and audits or reviews thereof by the Medicare administrative contractor. The Health System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Health System's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through March 31, 2012.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE B - NET PATIENT SERVICE REVENUE - Continued

Medicaid - Prior to January 1, 2013, hospital and inpatient geropsychiatric services rendered to Medicaid beneficiaries not enrolled in a Medicaid managed care plan were paid under cost reimbursement methodologies. After December 31, 2012, hospital and inpatient geropsychiatric services rendered to all Medicaid beneficiaries are paid at prospectively determined rates. Nursing facility services are paid at prospectively determined per diem rates set annually on the basis of cost information supplied by nursing facilities for preceding calendar years. The Health System is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health System and reviews thereof by the state Medicaid agency. The Health System's Medicaid cost reports have been audited or reviewed by the state Medicaid agency through March 31, 2011.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

The Health System has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Health System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

A summary of gross and net patient service revenue follows:

	<u>2014</u>	<u>2013</u>
Gross patient service revenue	\$ 44,065,815	\$ 43,610,016
Contractual adjustments	(18,643,451)	(16,971,304)
Provision for bad debts	(1,015,123)	(2,158,812)
Charity care	<u>(255,410)</u>	<u>(125,536)</u>
Net patient service revenue	<u>\$ 24,151,831</u>	<u>\$ 24,354,364</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 58 percent and 6 percent, respectively, of the Health System's net patient service revenue during 2014, and 59 percent and 6 percent, respectively, of the Health System's net patient service revenue during 2013. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVES

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA are intended to promote the adoption and meaningful use of interoperable health information technology and qualified EHR technology.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVES - Continued

The Health System recognizes revenue for EHR incentives when it has attested that it has demonstrated meaningful use of certified EHR technology for the applicable period and has complied with the reporting conditions to receive the payments. The demonstration of meaningful use is based upon meeting a series of objectives and varies between hospital facilities and physician practices and between the Medicare and Medicaid programs. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by CMS. During the year ended March 31, 2014, the Health System recognized \$944,591 of revenue related to EHR incentives.

The Health System incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiatives. The amounts and timing of these expenditures do not directly correlate with the timing of the Health System's recognition of EHR incentives as revenue.

NOTE D - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Health System, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury bills and notes, and the State Treasurer's investment pool. Kansas statutes also require that collateral be pledged for bank deposits with a fair value equal to 100 percent of the uninsured amounts and must be assigned for the benefit of the Health System.

At March 31, 2014, the carrying amount of the Health System's bank deposits, including certificates of deposit, was \$9,998,393 and the bank balances were \$10,026,259. Of the bank balances, \$716,406 was covered by federal depository insurance and \$9,309,853 was covered by collateral held by a third-party bank.

The Health System's bank deposits are included in the financial statements under the following categories:

Cash and cash equivalents	\$ 3,570,185
Assets limited as to use	
Internally designated	
For capital assets	4,732,490
For self-funded employee health insurance	408,900
Under bond agreements	1,250,831
By contributors	35,987
	<u>\$ 9,998,393</u>

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE E - ASSETS LIMITED AS TO USE

The composition of assets limited as to use is as follows:

	<u>2014</u>	<u>2013</u>
Internally designated for capital assets		
Cash	\$ 3,508,396	\$ 1,176,260
Certificates of deposit	1,224,094	1,214,682
Accrued interest receivable	<u>1,528</u>	<u>4,312</u>
	<u>\$ 4,734,018</u>	<u>\$ 2,395,254</u>
Internally designated for self-funded employee health insurance		
Cash	<u>\$ 408,900</u>	<u>\$ 587,808</u>
Under bond agreements		
Cash	\$ 134,426	\$ 127,000
Certificates of deposit	1,116,405	1,116,405
Accrued interest receivable	<u>232</u>	<u>438</u>
	<u>\$ 1,251,063</u>	<u>\$ 1,243,843</u>
By contributors for specific operating activities		
Cash	\$ 24,785	\$ 43,045
Certificates of deposit	<u>11,202</u>	<u>11,118</u>
	<u>\$ 35,987</u>	<u>\$ 54,163</u>
By contributors for capital asset acquisitions		
Cash held by Mitchell County		
Regional Medical Foundation	\$ 731	\$ 1,058
Pledges receivable	<u>83,875</u>	<u>252,739</u>
	<u>\$ 84,606</u>	<u>\$ 253,797</u>

NOTE F - INVESTMENTS

The Endowment Fund's investments are stated at fair value based upon quoted prices in active markets for identical assets. The composition of its investments is as follows:

	<u>2014</u>	<u>2013</u>
Common stocks	\$ 2,175,915	\$ 1,808,647
Mutual funds (equity and fixed income)	<u>1,530,638</u>	<u>1,202,418</u>
	<u>\$ 3,706,553</u>	<u>\$ 3,011,065</u>

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE G - CAPITAL ASSETS

Capital asset additions, retirements, and balances are as follows:

	2014			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 42,774	\$ -	\$ -	\$ 42,774
Land improvements	658,360			658,360
Buildings	19,746,112	178,881		19,924,993
Fixed equipment	5,365,678	9,400		5,375,078
Major movable equipment	11,278,397	545,673	7,484	11,816,586
Totals at historical cost	37,091,321	733,954	7,484	37,817,791
Less accumulated depreciation and amortization				
Land improvements	374,028	33,869		407,897
Buildings	7,415,746	976,643		8,392,389
Fixed equipment	4,028,278	228,389		4,256,667
Major movable equipment	8,148,107	1,129,128	7,484	9,269,751
	19,966,159	2,368,029	7,484	22,326,704
Construction in progress	17,125,162	(1,634,075)	-	15,491,087
	237,572	(17,325)		220,247
Capital assets, net	<u>\$17,362,734</u>	<u>\$ (1,651,400)</u>	<u>\$ -</u>	<u>\$15,711,334</u>

	2013			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 42,774	\$ -	\$ -	\$ 42,774
Land improvements	633,425	24,935		658,360
Buildings	19,575,382	170,730		19,746,112
Fixed equipment	5,365,678			5,365,678
Major movable equipment	10,900,941	377,456		11,278,397
Totals at historical cost	36,518,200	573,121	-	37,091,321
Less accumulated depreciation and amortization				
Land improvements	337,823	36,205		374,028
Buildings	6,434,582	981,164		7,415,746
Fixed equipment	3,794,947	233,331		4,028,278
Major movable equipment	6,973,091	1,175,016		8,148,107
	17,540,443	2,425,716	-	19,966,159
Construction in progress	18,977,757	(1,852,595)	-	17,125,162
	285,038	(47,466)		237,572
Capital assets, net	<u>\$19,262,795</u>	<u>\$ (1,900,061)</u>	<u>\$ -</u>	<u>\$17,362,734</u>

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE G - CAPITAL ASSETS - Continued

Construction in progress at March 31, 2014, consists primarily of costs incurred to date for surgical equipment and computer hardware and software not yet placed into service.

NOTE H - EMPLOYEE HEALTH INSURANCE

The Health System sponsors a self-insured employee health insurance plan. The Health System reinsures a portion of its risk under that plan. The reinsurance arrangement generally covers claims totaling over \$50,000 for each covered individual on an annual basis. The reinsurance arrangement also covers aggregate annual claims of the plan in excess of an amount determined in relation to the number of individuals participating in the plan during the plan year. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. The Health System has retained an agent to process and settle claims. The following is a summary of the activity under this arrangement:

	<u>2014</u>	<u>2013</u>
Estimated net health insurance claims payable at beginning of year	\$ 194,000	\$ 177,000
Provision for the Health System's share of incurred claims and related expenses for the year, net of any reinsurance proceeds	1,206,316	937,116
Participant contributions	444,239	453,245
Payments made for claims and related expenses	<u>(1,711,555)</u>	<u>(1,373,361)</u>
Estimated net health insurance claims payable at end of year (included in accrued salaries and benefits)	<u>\$ 133,000</u>	<u>\$ 194,000</u>

NOTE I - LONG-TERM OBLIGATIONS

Long-term obligations are summarized as follows:

	<u>2014</u>	<u>2013</u>
3.00% - 4.60% Mitchell County, Kansas Public Building Commission Refunding Revenue Bonds, Series 2009; issued on April 15, 2009, in the original amount of \$6,345,000; due serially through March 1, 2029; net of unamortized discount of \$13,744 in 2014 and \$15,301 in 2013	\$ 5,106,256	\$ 5,359,699

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE I - LONG-TERM OBLIGATIONS - Continued

	<u>2014</u>	<u>2013</u>
1.50% - 6.05% Mitchell County, Kansas Public Building Commission Taxable Revenue Bonds, Series 2009-2 (Build America Bonds - direct payment to issuer); issued on October 15, 2009, in the original amount of \$7,850,000; due serially through March 1, 2029	\$ 6,085,000	\$ 6,505,000
Capital lease obligations; imputed interest rates from 0% to 8.25%; collateralized by leased equipment with an amortized cost of \$485,255 at March 31, 2014	<u>534,705</u>	<u>856,052</u>
	11,725,961	12,720,751
Less current maturities	<u>968,200</u>	<u>1,155,815</u>
Long-term obligations net of current maturities	<u>\$ 10,757,761</u>	<u>\$ 11,564,936</u>

The following is a summary of changes in long-term obligations:

	Capital lease obligations	Hospital revenue bonds	Total long-term obligations
Outstanding at April 1, 2012	\$ 1,430,306	\$ 12,523,088	\$ 13,953,394
Principal payments	(574,254)	(660,000)	(1,234,254)
Amortization of bond discount	<u>1,611</u>	<u>1,611</u>	<u>1,611</u>
Outstanding at March 31, 2013	856,052	11,864,699	12,720,751
Obligations incurred	159,468		159,468
Principal payments	(480,815)	(675,000)	(1,155,815)
Amortization of bond discount	<u>1,557</u>	<u>1,557</u>	<u>1,557</u>
Outstanding at March 31, 2014	<u>\$ 534,705</u>	<u>\$ 11,191,256</u>	<u>\$ 11,725,961</u>

On September 1, 2002, the Mitchell County, Kansas, Public Building Commission (PBC) issued its Revenue Bonds, Series 2002 (the 2002 Bonds), in the amount of \$8,000,000, on behalf of the Health System pursuant to a bond resolution dated August 19, 2002. The proceeds of the 2002 Bonds were used, together with other available funds of the Health System, for the purpose of providing funds to (1) expand and renovate the existing Hospital building (the 2002 Project), (2) fund a debt service reserve fund for the 2002 Bonds, (3) pay the premium for the municipal bond insurance policy, and (4) pay certain costs related to the issuance of the 2002 Bonds.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE I - LONG-TERM OBLIGATIONS - Continued

On April 15, 2009, the PBC issued its Refunding Revenue Bonds, Series 2009 (the Refunding Bonds), in the amount of \$6,345,000, on behalf of the Health System pursuant to a bond resolution dated March 30, 2009. The proceeds of the Refunding Bonds were used, together with other available funds of the Health System, for the purpose of providing funds to (1) immediately refund the 2002 Bonds, (2) pay the premium for the municipal bond insurance policy, and (3) pay certain costs related to the issuance of the Refunding Bonds.

On October 15, 2009, the PBC issued its Taxable Revenue Bonds, Series 2009-2 (the 2009-2 Bonds), in the amount of \$7,850,000, on behalf of the Health System pursuant to a bond resolution dated September 24, 2009. The proceeds of the 2009-2 Bonds were used, together with other available funds of the Health System, for the purpose of providing funds to (1) expand and renovate the existing Hospital building (the 2009 Project), and (2) pay certain costs related to the issuance of the 2009-2 Bonds. The 2009-2 Bonds are qualified "build America bonds" under Section 54AA of the Internal Revenue Code. The PBC has elected to receive a direct payment from the United States Treasury equal to 35 percent of the interest payable on the 2009-2 Bonds.

The PBC is a municipal corporation created by the County during 2002 whose principal functions are acquiring land, and constructing, reconstructing, equipping, and furnishing buildings for lease to governmental entities, and to issue revenue bonds to finance those functions. The PBC, the County, and the Health System have entered into lease agreements in which the PBC leases the 2002 Project and the 2009 Project to the County and the Health System for rental payments sufficient to provide for the payment of principal and interest on the Refunding Bonds and the 2009-2 Bonds. The leases contain a covenant by the County to make all rental payments required under the leases from whatever source of revenues is legally available and to levy ad valorem taxes without limit if necessary to make such payments.

Timely payment of principal and interest on the Refunding Bonds is insured under a noncancelable policy insured by Assured Guaranty Corporation. The Refunding Bonds and the 2009-2 Bonds are secured by a guaranty agreement between the Endowment Fund (see Note A2) and the PBC. Under the guaranty agreement, the Endowment Fund has guaranteed the payment of principal and interest on the Refunding Bonds and the 2009-2 Bonds, not to exceed \$100,000 in any one twelve-month period.

The Health System and the County have also entered into a pledge of revenues agreement in which the Health System has pledged its net revenues to the County to secure the payment of principal and interest on the Refunding Bonds and the 2009-2 Bonds. The pledge of revenues agreement requires the Health System to make monthly deposits to a debt service account that are sufficient to pay principal and interest on the Refunding Bonds and the 2009-2 Bonds as payments are due. Such deposits were maintained and are included with assets limited as to use in the financial statements.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE I - LONG-TERM OBLIGATIONS - Continued

The pledge of revenues agreement includes a rate covenant that requires the level of rates, fees, and charges for services to be sufficient to produce net revenues, as defined, for each fiscal year equal to 100 percent of the debt service requirements for all bonds outstanding during that fiscal year. The Health System's net revenues, as defined, were equal to 193 percent and 207 percent of the debt service requirements for all bonds outstanding during the years ended March 31, 2014 and 2013, respectively.

Refunding of the 2002 bonds increased total future debt service requirements of the Health System by \$1,244,898 because the repayment period of the refunding debt extends seven years beyond that of the extinguished debt. This resulted in an economic loss (difference between the present value of the future debt service payments on the old and new debt) of \$159,073.

Scheduled annual debt service requirements on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 650,000	\$ 426,851	\$ 1,076,851
2016	670,000	404,587	1,074,587
2017	690,000	385,385	1,075,385
2018	710,000	362,812	1,072,812
2019	735,000	338,806	1,073,806
2020 - 2024	3,705,000	1,290,155	4,995,155
2025 - 2029	<u>4,045,000</u>	<u>527,006</u>	<u>4,572,006</u>
	<u>\$ 11,205,000</u>	<u>\$ 3,735,602</u>	<u>\$ 14,940,602</u>

The following is a yearly schedule of future minimum lease payments under capital leases as of March 31, 2014:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 318,200	\$ 26,554	\$ 344,754
2016	186,267	10,322	196,589
2017	<u>30,238</u>	<u>312</u>	<u>30,550</u>
Total minimum lease payments	<u>\$ 534,705</u>	<u>\$ 37,188</u>	571,893
Less amounts representing interest			<u>37,188</u>
Present value of net minimum lease payments			<u>\$ 534,705</u>

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE I - LONG-TERM OBLIGATIONS - Continued

Total interest costs are summarized as follows:

	<u>2014</u>	<u>2013</u>
Total interest incurred	\$ 607,033	\$ 636,111
Amortization of bond discount	<u>1,557</u>	<u>1,611</u>
	608,590	637,722
Less		
Build America bonds tax credit payment	<u>(110,861)</u>	<u>(125,258)</u>
Interest expense	<u>\$ 497,729</u>	<u>\$ 512,464</u>

NOTE J - PENSION PLANS

The Health System sponsors two defined contribution pension plans that provide pension benefits for all of its employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan, plus investment earnings. The plans are administered by a third-party insurance company and can be amended by the Board of Trustees. The provisions of the plans are as follows:

An Internal Revenue Code Section 414 plan requires mandatory participation upon employment. Concurrent with the establishment of this plan, the Health System ceased to participate in the Federal Social Security System. Both employees and the Health System contribute 6.2 percent of participant compensation to the plan, subject to certain limitations. Employees are 100 percent vested in all contributions upon participation in the plan.

An Internal Revenue Code Section 403(b) tax sheltered annuity plan permits voluntary participation. Employees become eligible for employer contributions after completing one year of service. Employees may make contributions to the plan subject to maximum limits established by the Internal Revenue Service. The Health System makes matching contributions at a specified percentage of participant contributions up to a maximum of 4 percent of each participant's compensation. Employer contributions vest 20 percent per year of service and are fully vested at the end of five years of service.

Total expense incurred for these plans during the years ended March 31, 2014 and 2013, was \$1,074,477 and \$1,059,658, respectively.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE K - CONCENTRATION OF CREDIT RISK

The Health System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of patient accounts receivable from patients and third-party payors at March 31, 2014 and 2013, is as follows:

	<u>2014</u>	<u>2013</u>
Medicare	42.2%	45.4%
Medicaid	6.8	5.3
Blue Cross	12.2	17.1
Other insurers	7.5	7.4
Patients	<u>31.3</u>	<u>24.8</u>
	<u>100.0%</u>	<u>100.0%</u>

NOTE L - RISK MANAGEMENT

For the years ended March 31, 2014 and 2013, the Health System was insured for hospital professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Health System is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. The policy provided by the independent insurance carrier provides for umbrella liability in excess of the underlying limits set forth above in the amount of \$1,000,000 per occurrence with an aggregate amount in any policy period of \$3,000,000. All coverage is on a claims-made basis. The above policies were renewed on January 1, 2014, for the policy period from January 1, 2014 to January 1, 2015.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, the Health System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors or omissions; injuries to employees; and natural disasters. The Health System purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

NOTE M - COMMITMENTS AND CONTINGENCIES

The Health System purchases professional and general liability insurance to cover medical malpractice and other liability claims (see Note L). There are no known claims or incidents that have been asserted. No accrual for loss contingencies related to unasserted claims, if any, has been made in the financial statements as the amount of ultimate settlement, if any, cannot be reasonably estimated.

The Health System has outstanding purchase commitments totaling \$286,631 as of March 31, 2014, for acquisition of a patient monitoring system.

MITCHELL COUNTY HOSPITAL HEALTH SYSTEMS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
March 31, 2014 and 2013

NOTE N - RELATED PARTY TRANSACTIONS

The NCK Wellness Center, Inc. (the Wellness Center), was incorporated on January 4, 2006. The Health System, the City of Beloit, and the North Central Kansas Technical College are the members of the Wellness Center which is a not-for-profit membership corporation.

The Health System incurred \$44,739 and \$45,898 in employee compensation expenses on behalf of the Wellness Center during the years ended March 31, 2014 and 2013, respectively. The Wellness Center reimbursed the Health System for \$51,175 and \$49,710 of these expenses during the years ended March 31, 2014 and 2013, respectively. The reimbursements are included in other operating revenue in the financial statements. Amounts due from the Wellness Center totaled \$8,400 and \$4,175 at March 31, 2014 and 2013, respectively, and are included in other receivables.

The County levies ad valorem taxes for the benefit of the Health System and remits these taxes as they are collected.

The Mitchell County Regional Medical Foundation (the Foundation) was incorporated on December 22, 2008. The Foundation's purpose is to foster medical needs of Mitchell County and the surrounding region, including those of the Health System. The Foundation's board of directors consists of eleven members, including the Health System's chief executive officer, the Health System's chief financial officer, and two members of the Health System's board of trustees. The Foundation is assisting with the Health System's efforts to raise donated funds to help pay for renovations and additions to the Health System's facilities. The Health System incurred expenses of \$64,003 and \$53,661 in connection with the fundraising campaign during the years ended March 31, 2014 and 2013, respectively.

NOTE O - SUBSEQUENT EVENT

On June 10, 2014, the PBC issued its Refunding Revenue Bonds, Series 2014 (the 2014 Bonds), in the amount of \$6,015,000, on behalf of the Health System pursuant to a bond resolution dated May 19, 2014. The proceeds of the 2014 Bonds were used, together with available funds of the Health System, for the purpose of providing funds to (1) immediately refund the 2009-2 Bonds (see Note I), and (2) pay certain costs related to the issuance of the 2014 Bonds.

The 2014 Bonds mature serially beginning on March 1, 2015 through March 1, 2029, and bear interest at rates from 2.00 percent to 3.75 percent. Annual debt service requirements on the 2014 Bonds range from \$166,000 to \$587,450.